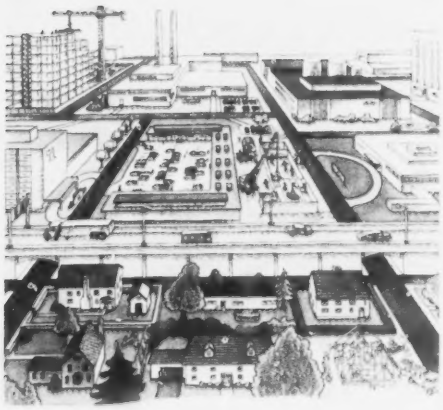
1984 Dodge/Sweet's Construction Outlook

First Update
March 1984



Stability has replaced expansion as the word that best describes the present state of the building industry. The Dodge Index of total construction contract value, which is the leading indicator of building materials demand and expenditures for construction put in place, has been doing no better than drifting sideways ever since it reached the lofty 140's last summer. Not that 140 is a bad place to be, considering the depressed state of the construction market two years ago, when this Index sank to its recent low of only 92. The climb back from 92 to the current 140 level brought a welcome infusion of more than $65 billion of new construction to the building market. Still, it's hard to avoid the reality that recovery, vigorous as it was between mid-1982 and mid-1983, has stalled. Is the building cycle experiencing burnout?

How It Happened

A glance over the shoulder shows how and when this cycle lost its momentum. Recovery began in the spring of 1982 when interest rates broke. Housing starts surged in response. A year later, when interest rates stopped falling, housing activity plateaued. And that's almost all there is to it—but not quite.

During 1983, the second stage of recovery began to take hold on the nonresidential side of the building market. The stability of *total* contracting since mid-1983 conceals a trade-off: quarter-by-quarter improvement in commercial and industrial building has been taking up the slack left by the hesitant housing sector. This transition from housing to nonresidential construction as the building market's driving force during 1983 opens an alternative path to renewed expansion.

It is by no means certain, however, that the housing cycle has reached its peak. Demand is strong (as indicated by January's spurt to 1.9 million units), and the potential exists for a modest further gain beyond 1983's volume of starts as long as mortgage rates are not driven up.

What Happens Next?

A bigger potential remains to be realized in commercial and industrial building, which still has a long way to go to establish a normal relationship with the level of building already achieved in the housing market. Of course, it takes more than a housing recovery to stimulate nonresidential building. Commercial and industrial construction needs the support of a strong economy, and here too, the signs are generally favorable. Last year's rebound of consumer spending has already set off a wave of contracting for stores and shopping centers. Rising employment supports most types of commercial building, but is particularly important to offices. Capacity utilization, which jumped from 69 percent to 80 percent over the past year, is the key to the turnaround of industrial construction. Meanwhile, the economy continues to race ahead, powered by the fiscal thrust of the huge Federal deficit. Unfortunately, the reluctance to come to grips with the deficit increases the risk of countervailing monetary restraint.

Most of the pieces seem to be falling into place for another good year for the construction industry, and 1984 can be thought of as an extension of the positive developments that have taken root since mid-1982.

- Commercial and industrial building—with the exception of offices—will be moving into the strongest phase of its cycle.
- Housing demand in 1984 will be as good as last year (or a bit better), reaching as high as 1.8 million units.
- Institutional building will continue to provide steady support in the future as it has in the past.

Commercial/Industrial Building

By the start of 1984, contracting for commercial and industrial building had already advanced 30 percent from its cyclical low point (1982:IV) to a seasonally adjusted rate of 824 million square feet. Most of this improvement took place in retail building (stores and warehouses) which, due to its close link with homebuilding, is normally the first business-related category to recover.

Contracting for *retail building* has considerable room for improvement in order to match the spectacular achievement of the housing market between mid-1982 and mid-1983. Experience indicates that a rate of housing starts of 1.7 million units per year is capable of supporting approximately 400 million square feet of store and warehouse construction annually. Despite last year's encouraging recovery of retail building, the current rate of contracting is only a little over 300 million square feet. To establish parity with homebuilding, there is potential for further improvement in retail building of at least another 20 percent in 1984. If housing starts reach 1.8 million this year as expected, the potential for stores and warehouses will be closer to a gain of 25 percent.

The response of *industrial building* to 1983's economic recovery was, and continues to be, unusually strong. The most likely explanation for 1983's uncharacteristically early rebound of contracting for manufacturing buildings is that after a decade or more of underinvestment, much existing manufacturing capacity is obsolete. One reason why the rate of capacity utilization advanced so rapidly during 1983's recovery is that many idle plants have been closed forever.

As the point of departure for the future, the improvement in the seasonally adjusted rate of contracting for manufacturing buildings between the first and fourth quarters of 1983 needs to be put into perspective. Due to the extremely depressed state of this market at its cyclical low point (1983:I), last year's quarter-by-quarter gains still left the full year's total square footage 10 percent *below* 1982's volume—the fourth consecutive annual decline. And while 1983's developments were highly significant in turning that four-year decline around, the 122-million-square-foot rate of contracting reached by the fourth quarter was still far below the potential indicated by a capacity utilization rate of 80 percent.

Considering that the rate of contracting had already passed 120 million square feet by the end of 1983, a forecast of 140 million in 1984 hardly stretches credibility, even though it implies a year-to-year gain of 31 percent. It is worth remembering that 145 million square feet of industrial construction was contracted in the worst year of the 1975 recession.

The inevitable retreat from 1981's

1984 National Estimates
Dodge Construction Potentials

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		1983 Actual	1984 Forecast	Percent Change 1984/83
Nonresidential Buildings				
Floor Area (millions of square feet)	Office Buildings	281		−16
	Stores & Other Commercial	362		+23
	Manufacturing Buildings	107		+31
	Total Commercial & Manufacturing	750		+10
	Educational	73		−12
	Hospital & Health	84		−6
	Other Nonresidential Buildings	116		+16
	Total Institutional & Other	273		+ 1
	Total Nonresidential Buildings	1,023		+ 7
Contract Value (millions of dollars)	Office Buildings	$ 19,766		−11
	Stores & Other Commercial	13,798		+25
	Manufacturing Buildings	5,080		+48
	Total Commercial & Manufacturing	$ 38,644		+10
	Educational	$ 6,157		−7
	Hospital & Health	8,560		+ 1
	Other Nonresidential Buildings	8,544		+14
	Total Institutional & Other	$ 23,261		+ 4
	Total Nonresidential Buildings	$ 61,905		+ 8
Residential Buildings				
Dwelling Units** (thousands of units)	One-Family Houses	1,000	1,125	+13
	Multi-Family Housing	719	675	− 6
	Total Housekeeping Residential	1,719		+ 5
Floor Area (millions of square feet)	One-Family Houses	1,578		+12
	Multi-Family Housing	682		− 5
	Nonhousekeeping Residential	78		− 4
	Total Residential Buildings	2,338		+ 7
Contract Value (millions of dollars)	One-Family Houses	$ 61,765		+19
	Multi-Family Housing	25,919		+ 1
	Nonhousekeeping Residential	5,517		+ 3
	Total Residential Buildings	$ 93,201		+13
Nonbuilding Construction				
Contract Value (millions of dollars)	Highways & Bridges	$ 15,219		+13
	Sewer & Water	7,536		− 1
	Other Public Works	7,210		+ 3
	Total Public Works	$ 29,965		+ 7
	Utilities	$ 7,680		− 9
	Total Nonbuilding Construction	$ 37,645		+ 4
All Construction				
Contract Value (millions of dollars)	Total Construction	$192,751		+ 9
	Dodge Index (1977 = 100)	138		

** F.A. Dodge basis

1984 Regional Estimates
Dodge Construction Potentials

First Update
March 1984

Northeast (CT, ME, MA, NH, NJ, NY, PA, RI, VT)	1983 Actual	1984 Forecast	Percent Change 1984/83
Contract Value (millions of dollars)			
Nonresidential Buildings			
Commercial and Manufacturing	$ 5,912		+ 11
Institutional and Other	4,160		+ 2
Total	$10,152		+ 7
Residential Buildings			
One-Family Houses	$ 6,871		+22
Multi-Family Housing	3,607		+16
Nonhousekeeping Residential	986		+14
Total	$11,464		+20
Nonbuilding Construction			
Highways and Bridges	$ 2,387		+16
Other Public Works	2,830		+ 1
Utilities	313		+60
Total	$ 5,530		+11
	$27,126		+13

South (AL, AR, DE, DC, FL, GA, KY, LA, MD, MS, NC, OK, SC, TN, TX, VA, WV)	1983 Actual	1984 Forecast	Percent Change 1984/83
Contract Value (millions of dollars)			
Nonresidential Buildings			
Commercial and Manufacturing	$15,575		+ 10
Institutional and Other	8,941		+ 3
Total	$24,516		+ 7
Residential Buildings			
One-Family Houses	$29,148		+15
Multi-Family Housing	12,686		5
Nonhousekeeping Residential	2,386		+ 4
Total	$44,220		+ 8
Nonbuilding Construction			
Highways and Bridges	$ 5,798		+13
Other Public Works	5,259		+ 2
Utilities	2,151		+26
Total	$13,208		+10
Total Construction	$81,944		+ 8

North Central (IL, IN, IA, KS, MI, MN, MO, NE, ND, OH, SD, WI)	1983 Actual	1984 Forecast	Percent Change 1984/83
Contract Value (millions of dollars)			
Nonresidential Buildings			
Commercial and Manufacturing	$ 7,314		+11
Institutional & Other	4,513		+ 4
Total	$11,827		+ 6
Residential Buildings			
One-Family Houses	$ 9,867		+19
Multi-Family Housing	3,211		+ 6
Nonhousekeeping Residential	683		1
Total	$13,761		+15
Nonbuilding Construction			
Highways and Bridges	$ 4,204		+ 8
Other Public Works	3,011		1
Utilities	1,376		13
Total	$ 8,591		+ 2
Total Construction	$34,179		+ 9

West (AK, AZ, CA, CO, HI, ID, MT, NV, NM, OR, UT, WA, WY)	1983 Actual	1984 Forecast	Percent Change 1984/83
Contract Value (millions of dollars)			
Nonresidential Buildings			
Commercial and Manufacturing	$ 9,783		+ 7
Institutional & Other	5,647		+ 7
Total	$15,430		+ 7
Residential Buildings			
One-Family Houses	$15,879		+24
Multi-Family Housing	6,415		+ 2
Nonhousekeeping Residential	1,462		+ 8
Total	$23,756		+17
Nonbuilding Construction			
Highways and Bridges	$ 2,830		+18
Other Public Works	3,646		+ 2
Utilities	3,840		32
Total	$10,316		+ 6
Total Construction	$49,502		+ 9

all-time peak of 325 million square feet of contracting for *office buildings* began in 1982 as newly started work settled back 20 percent to 261 million square feet. That decline was temporarily reversed in 1983, however, when contracting rebounded to 281 million square feet.

The surprising "second life" of the office building boom may be the result of the accelerated depreciation provision of the 1981 tax legislation (ERTA). Whatever the reason, two critical numbers indicate the extent of the adjustment that lies ahead in order to restore supply/demand balance in the office building market.

- It is estimated that the national surplus of office space (both completed and under construction) exceeds 200 million square feet.
- Diminishing growth of the white collar labor force by the mid-1980's will require net additions of no more than 225 million square feet per year.

Taken together, these two limiting factors imply that the annual volume of building must be brought below 225 million square feet per year for as long as it takes to absorb the already existing surplus. After that, it should be possible to sustain an average rate of 225 million square feet per year of new construction. This compares with the 270 million

per year average actually started during the past five years.

The forecast of 236 million square feet in 1984 (16 percent below 1983's volume) will do little to clear the market of its surplus, and implies still lower rates for building in the years that follow.

Residential Building

Recent experience seems to show that stable mortgage rates in the range of 12 to 13 percent can continue to support a volume of housing starts in the range of 1.7 to 1.8 million units. To break out of that range—in either direction—requires a change in the level of interest rates.

In pursuit of its dual objectives of containing inflation while supporting the economy's growth, the Federal Reserve has little room to move toward either tightness or ease without upsetting the economy's delicate balance. (The credit-induced recession of 1981 is an all too recent example of what "Fed-power" can do at this stage of the business cycle.) Since the immediate threat of inflation is considerably less urgent than the need to support economic expansion at least through 1984, sound central banking policy means holding a steady monetary course as long as the economy is not in danger of overheating, leaning as much as necessary in the direction of ease for the balance of the current year, and in the direction of restraint after 1984.

This scenario, which makes the case for a small (and temporary) decline in mortgage rates in the middle of 1984, allows room for a further modest improvement in housing starts this year. Compared with the dramatic rise from 1.1 million to 1.7 million in 1983, however, the remaining potential of the current housing cycle for 1984 is meager. With little likelihood that mortgage rates will fall below an average of 12½ percent for the year, the upper limit of housing starts cannot be much above 1.8 million. Moreover, the probability that interest rates will begin rising again toward the end of 1984, and will march steadily upward in the post-election years, virtually establishes 1984 as the peak of the housing cycle. However, the expected quarterly pattern through 1984 (I @ 1.750; II @ 1.775; III @ 1.850; IV @ 1.825) implies a reasonably strong beginning for 1985. If interest rates rise only gently next year (one-half percent), 1985's volume could hold as high as 1.7 million units.

Public Works Construction

The steady decline of contracting for public works construction since 1979 was reversed dramatically early in 1983. That was when budgetary restraint yielded to the more traditional use of public works to help the economy make its way out of deep recession.

Two Federal programs, the Emergency Jobs Act (EJA) and the Surface Transportation Assistance Act (STAA), were the vehicles for channeling extra billions of dollars into public works construction in 1983. The result: a record $30 billion of contracting for highways and bridges, mass transit, water resources, waste water treatment facilities, and other public projects.

Although EJA was little more than a device for speeding up the expenditure of already appropriated funds for already existing programs, STAA—through its new 5¢-per-gallon fuel tax—is now delivering upwards of $5 billion a year of *additional* Federal funds, and the stream will continue for several years. Eighty percent of these "user fees" is dedicated to highway and bridge construction; the balance is pledged to mass transit. By the time STAA expires, this program will be largely responsible for raising the annual value of contracting for public works construction from its current $30 billion to a peak of $35 billion in 1986.

In 1984, contracting for highways and bridges will enjoy a built-in gain owing to the timing of STAA. This year the program will be operative for a full twelve months, compared with its actual nine months' effectiveness in 1983. The extra quarter's allocation will lift 1984's total highway/bridge contract value another 14 percent to $17.2 billion.

With contracting for most other public works projects holding close to their 1983 rates, total public works construction is forecast to increase by 7 percent in 1984.

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The Outlook

Nonresidential Building Contract Value

Seasonally adjusted annual rates, in billions of dollars

Year/Quarter		Total	Commercial/ Industrial	Institutional
1983	I	$59.5	$37.2	$22.3
	II	60.1	36.4	23.7
	III	63.1	40.2	22.9
	IV	64.8	40.6	24.2
1984	I	$60.8	$36.5	$24.4
	II	61.5	37.5	24.0
	III	62.5	41.5	21.4
	IV	63.5	41.0	22.5
1983		$61.9	$38.6	$23.3
1984		62.1	39.1	23.0
% Change		+ 8	+ 10	+ 4

Residential Building Contract Value

Seasonally adjusted annual rates, in billions of dollars

Year/Quarter		Total	One Family	Multi-Family*
1983	I	$ 84.5	$57.1	$27.4
	II	92.7	63.9	28.8
	III	99.1	63.7	35.4
	IV	96.4	62.3	34.1
1984	I	$ 98.3	$67.2	$31.1
	II	102.9	71.6	31.3
	III	109.9	77.6	32.3
	IV	108.1	77.1	32.6
1983		$ 93.2	$61.8	$31.4
1984		104.8	73.4	31.8
% Change		+13	+19	+ 1

*Includes Nonhousekeeping Residential Buildings

Nonbuilding Construction Contract Value

Seasonally adjusted annual rates, in billions of dollars

Year/Quarter		Total	Public Works	Utilities
1983	I	$31.8	$25.8	$ 6.0
	II	48.8	32.1	16.7
	III	38.8	32.3	6.5
	IV	31.2	29.6	1.6
1984	I	$36.3	$31.4	$ 6.9
	II	38.7	31.9	6.8
	III	32.3	32.3	7.0
	IV	40.2	40.8	7.4
1983		$37.7	$30.0	$ 7.7
1984		36.7	32.1	6.8
% Change		+ 4	+ 7	- 9